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APPLICATION OF

COLUMBIA GAS OF VIRGINIA, INC.

CASE NO. PUE990781

**For approval of a special
rate and contract**

REPORT OF MICHAEL D. THOMAS, HEARING EXAMINER

June 8, 2000

HISTORY OF THE CASE

On November 12, 1999, Columbia Gas of Virginia, Inc. ("Columbia") filed an Application for Approval of a Special Rate and Contract (the "Application") pursuant to § 56-235.2 of the Code of Virginia. Columbia seeks approval of its agreement of January 26, 1999, with Chaparral (Virginia) Inc. ("Chaparral") for firm transportation of natural gas and balancing services for Chaparral's steel recycling mill in Dinwiddie County. Columbia requested confidential treatment of parts of the Application and attached materials and filed a redacted copy to be placed in the Commission's public file.

On January 13, 2000, the Commission entered an Order for Notice and Hearing establishing a procedural schedule in this matter. Among other things, the Commission requested that Columbia supplement its Application to explain why confidential treatment of its Application was required. The Commission also invited Columbia to request the entry of an order governing confidential treatment of materials filed in this proceeding.

On January 24, 2000, Columbia filed with the Commission a Motion for Protective Order, along with a draft protective order. In support of its Motion, Columbia argued that its Application contained financial information that could be detrimental to Chaparral if released to Chaparral's competitors. The information might provide Chaparral's competitors a valuable insight into a key component of Chaparral's production costs as well as anticipated plant production factors. Columbia further argued the release of such information could be detrimental to its position in future negotiations with other potential customers for special rates or rates under its LVTS rate schedule by setting an inappropriate benchmark in negotiating such rates. The confidential information redacted from the public version of the Application includes sensitive contract provisions, Columbia's total capital investment in the facilities constructed to serve Chaparral, cost of service studies (with Chaparral), and class rates of return (with Chaparral). The contract provisions withheld from public disclosure include the rate, term, maximum daily quantity (and associated delivery pressure), annual consumption and retainage.

By Ruling entered on January 27, 2000, the Staff and other interested parties were provided an opportunity to file comments to Columbia's Motion for Protective Order.

The Staff filed its response to Columbia's Motion on February 4, 2000. The Staff did not object to the entry of a protective order in this case. However, the Staff took issue with the draft protective order appended to Columbia's Motion. The Staff opposed any requirement that would require it to sign an agreement to gain access to confidential information filed with the Clerk. The Staff argued that such a requirement is inconsistent with the protective order entered in the only other application for a special rate and contract, and it is inconsistent with Guideline 2 of the Guidelines for Filing an Application to Provide Electric and Gas Service under a Special Rate, Contract, or Incentive, 20 VAC 5-310-10, adopted in Case No. PUE970695. The portion of the regulation relied on by the Staff provides that:

[u]nredacted copies of documents containing information so marked shall be withheld from public disclosure by the clerk of the commission for commission and staff review unless disclosure is ordered by the commission. Copies of documents redacted to exclude confidential information shall be filed and placed in the public file.

The Staff further objected to Columbia's characterization in its draft protective order of two types of confidential information, "confidential information" and "detrimental confidential information." The Staff argued the language in the draft protective order was ambiguous and suggested a subjective classification by Columbia of those who may have access to "detrimental confidential information." The Staff argued in favor of a protective order similar to the one entered by the Commission in *Application of Virginia Electric and Power Company, For approval of a special rate and contract pursuant to § 56-235.6 of the Code of Virginia*, Case No. PUE980333 (July 16, 1998, Protective Order, D.C.C No. 980730028).

On February 10, 2000, Columbia filed a Reply to the Staff's Response. In its Reply, Columbia argued that it proposed the requirement that each party sign an agreement to gain access to confidential information to ensure that each party understood its obligation to keep such information confidential. Additionally, Columbia argued the Staff's objection to classifying certain information "detrimental confidential information" ignored the highly competitive environment in which Chaparral operates, and the potential harm Columbia and/or Chaparral would suffer if such information were disclosed to the wrong party.

By Hearing Examiner's Ruling entered on February 17, 2000, a protective ruling was entered which provided the Staff access to confidential information in Columbia's Application without having to sign an agreement to gain access to the information. The protective ruling further established a procedure to protect the disclosure of confidential information to competitors or customers of Columbia or Chaparral.

On February 28, 2000, Chaparral filed a Notice of Protest with the Commission. In its Notice of Protest, Chaparral argued that it is a party to the agreement for firm transportation of natural gas and balancing services that is the subject of this case, therefore, it has a direct interest in the outcome of the proceeding. Chaparral further argued no other party could adequately represent its interests in this proceeding.

Chaparral filed its Protest on March 6, 2000. In its Protest, Chaparral stated that it expects to invest in excess of \$400 million in the construction of its steel recycling facility, which is expected to produce approximately 1.2 million tons of structural steel annually. The facility will employ over 400 workers with an annual payroll in excess of \$14 million. The facility requires significant quantities of natural gas to operate the electric arc furnace burners, preheat and reheat furnaces, and the preheating stations. The cost of gas represents a substantial portion of the expense of production. Economy and stability in the cost of electric and gas services are essential to the company's operations. Chaparral further stated that the ability to enter into a firm gas transportation contract with Columbia had a direct impact on Chaparral's decision to locate its facility in Virginia. Chaparral adopted the prefiled testimony of Larry L. Clark, which was filed with Columbia's application, as its position in this case.

The hearing on Columbia's Application was convened as scheduled on April 12, 2000. Columbia appeared by its counsel James S. Copenhaver, Esquire and Kodwo Ghartey-Tagoe, Esquire. Chaparral appeared by its counsel Michael E. Kaufmann, Esquire. The Staff appeared by its counsel Wayne N. Smith, Esquire and Sherry H. Bridewell, Esquire. Columbia's proof of public notice was received into the record as Exhibit A. One public witness appeared to testify in favor of Columbia's Application. Pursuant to an agreement of the parties, the prefiled direct and rebuttal testimony, including errata sheet, of Columbia and the prefiled direct testimony, including errata sheet, of the Staff was accepted into the record without cross-examination.

SUMMARY OF THE RECORD

The only public witness to appear at the hearing was John Sternlicht, director of community relations, policy and legislation for the Virginia economic development partnership. The Virginia economic development partnership is responsible for executing the Commonwealth's economic development program, which includes recruiting new businesses to locate in Virginia and assisting existing Virginia businesses to expand. Mr. Sternlicht testified that Columbia and other utilities have been effective allies in recruiting new businesses to Virginia. He works directly with new businesses and utilities, such as Columbia, to create a package that would induce the business to locate in Virginia. To many businesses looking to locate to Virginia, the cost and availability of gas service is a major factor in their decision to locate here. In this particular case, Mr. Sternlicht testified that it was eminently clear from the beginning of Virginia's dealings with Chaparral that gas rates were of critical importance to Chaparral. It was his belief that, absent some showing that Virginia was willing to permit special gas rates, Chaparral would most likely have located its steel-recycling mill outside Virginia. (Tr. at 13-17).

Mr. Sternlicht further testified the Chaparral steel mill has resulted in an investment of over \$500 million in Dinwiddie County, which is 25% higher than originally announced. As of January 2000, the facility has created 464 full-time jobs with an average annual salary, including benefits, of \$44,000.00. Over the first 20 years of operation, it is estimated that Virginia will realize more than \$120 million in new state tax revenues from the direct and indirect impacts of the Chaparral steel mill. In addition, several other industries have located in the area as a result of Chaparral's decision to site its facility in Dinwiddie County. These industries created at least 280 additional jobs and represent new capital investment of \$40 million in the region. (*Id.*).

In support of its Application, Columbia prefiled the testimony of two witnesses: Mr. Robert W. Horner, regulatory services manager for Columbia; and Larry W. Clark, vice president and controller of Texas Industries, Inc., the parent company of Chaparral.

Mr. Horner's testimony covered the operating provisions of the special rate, the purpose of the rate, the process used to determine the rate, the treatment of the rate for ratemaking purposes, the impact of the rate on other customers' rates and service reliability, and the impact of the rate on economic development in the region. Columbia's agreement with Chaparral provides that it construct, own and operate the facilities necessary to provide natural gas service to Chaparral. The agreement contemplates that Columbia will provide firm gas transportation service to Chaparral pursuant to a negotiated rate that is otherwise consistent with its TS-2 rate schedule. A banking and balancing rate will also be charged depending on Chaparral's tolerance level election as provided in the TS-2 rate schedule. Columbia installed 24,640 feet of 8-inch high-pressure steel main, a point of delivery, an M&R station, and a service line to serve the steel mill. Columbia has incurred minimal administrative expenses in the negotiation of the agreement and the filing of this Application. (Ex. REH-2, at 2-4).

Mr. Horner testified that throughout the negotiations Chaparral maintained that a more economical rate than the company's existing transportation tariffs would be required for Chaparral to locate in Columbia's service territory. Ultimately, Chaparral agreed to accept service utilizing the provisions of the company's TS-2 rate schedule, including balancing provisions, and the applicable General Terms and Conditions with the exception of the rate. The negotiated rate is designed to recover Columbia's costs plus a return on its capital investment. The return on rate base received from Chaparral will be positive on all rate classes except for the company's LVTS class. There will be a slight reduction in the LVTS return, however, it remains above the company's overall cost of capital of 8.96% based on the midpoint of the authorized return on equity range approved by the Commission in Case No. PUE970455. (*Id.* at 4-8).

Mr. Horner further testified that service to Chaparral will not jeopardize reliable service to the company's other customers. The service to Chaparral's steel mill required the construction of pipeline distribution facilities that are not connected to any other part of Columbia's system. Columbia constructed the minimum sized pipeline necessary to serve Chaparral's load; however, the pipeline capacity exceeds the capacity necessary to serve Chaparral's mill. The distribution system has sufficient capacity to serve additional customers located near the mill. (*Id.* at 9).

Mr. Horner elaborated on the additional businesses that have chosen to locate in the area as a result of Chaparral's decision to construct its steel mill in Dinwiddie County. Two companies, Air Products and Olympic Mill Services, provide services directly to Chaparral. Two other companies, L.B. Foster and Namasco are "spin-off industries" that utilize the output from Chaparral's mill. Another company, Metlspan, decided to locate its business in the area after it learned of Chaparral's decision to locate in Dinwiddie County. (*Id.* at 9-10).

Finally, Mr. Horner testified Columbia's customers would benefit from the agreement as the result of lower rates stemming from better system utilization and the contribution to fixed costs by Chaparral. (*Id.* at 10).

Mr. Clark's testimony covered the areas of specialty steel production and Chaparral's role in that business, the operations of its new steel mill in Virginia, the process by which Chaparral decided to locate its mill in Virginia, the negotiations between Chaparral and Columbia surrounding the special rate, and the importance of economically competitive prices for energy in general and for gas in particular in Chaparral's decision to locate its steel mill in Virginia. (Ex. LC-3, at 2).

The Chaparral companies produce bar and structural steel products by recycling scrap steel, such as junked cars and other materials. They use a market mill concept, which entails producing a wide variety of products at low cost ranging from reinforcing bar, specialty steel products to large structural beams. The Chaparral companies have the ability to adjust their output quickly to recognize changing market conditions and customer demand. Their products are sold primarily to the construction, railroad, automobile, mobile home and energy industries. Their products are distributed primarily in North America, and in some cases to Europe and Asia. Chaparral expects the new mill's location and its advanced production technology to offer distribution and cost advantages that will enable Chaparral to meet market demand. The new mill is the first to combine Chaparral's patented energy efficient Near Net Shape Casting technology with state-of-the-art melting technology and a proprietary Chaparral-Schloeman designed rolling mill, which produces steel more energy efficiently and at a lower cost. The mill will include an automobile shredder, electric arc furnace, a ladle refining furnace, two continuous casters, preheat and reheat furnaces, an industrial gas production facility, a rolling mill, and an on-site storage facility. The electric arc furnace burners, preheat and reheat furnaces, and the preheating stations are the largest consumers of natural gas at the mill. Natural gas is used in other production processing equipment, but to a lesser extent. The mill will also be heated by natural gas. The mill is expected to operate virtually around the clock. There will be 20 eight-hour production shifts and 1 eight-hour maintenance shift each week. At full production, the mill is expected to produce approximately 1.2 million tons of structural steel annually. (*Id.* at 1-5).

Mr. Clark testified that energy costs are critical to the success or failure of a specialty steel mill. There are three primary costs associated with steel production in such a mill. Those are electric power, scrap metal and labor. Although not a primary cost, natural gas costs for the mill are expected to be roughly one-half the cost of its electric power. Chaparral has entered into a special rate contract with Virginia Power, which was approved by the Commission. Chaparral now seeks approval of its special rate contract with Columbia for firm gas transmission service. (*Id.* at 7).

Mr. Clark testified that in the selection process for the location of Chaparral's new steel mill, Virginia's political and regulatory environment, which had already recognized the importance of special energy requirements for large manufacturers, tipped the decision in favor of locating its mill in Virginia. Mr. Clark further testified that Va. Code § 56-235.2 and the Commission's guidelines for special rates were crucially important in their decision to locate in Virginia. Without the statute and the guidelines, Chaparral would not have chosen Virginia as contender, let alone as the finalist. Mr. Clark believes the statute is serving its intended purpose of providing sufficient flexibility for utilities to be more competitive in attracting new businesses to Virginia. Chaparral never considered Columbia's standard tariff rates as a viable option. Most new steel recycling mills buy gas and electricity pursuant to special services contracts or tariffs designed for their industry. Most standard tariffs cannot meet the special requirements and operating characteristics of steel recycling mills. The special gas transportation contract with Columbia fills several critical needs for

Chaparral: (1) economical cost; (2) adequate and economical pipeline facilities; and (3) predictable expense. (*Id.* at 9-11).

The Staff prefiled the testimony of three witnesses: Mark Carsley, principal research analyst in the Division of Economics and Finance; Howard M. Spinner, senior utilities specialist in the Division of Energy Regulation; and Rosemary M. Henderson, senior utilities analyst in the Division of Energy Regulation.

Mr. Carsley's testimony covered the economic impact study prepared by Dr. Roger Stough and Mr. Peter Arena of the Center for Regional Analysis ("CRA") at George Mason University entitled, "The Contribution of Chaparral Steel to the Regional Economy: 1998 With Forecasts to 2020" (the "CRA study"), which was referenced at page 5 of Columbia's Application and in page 14 of Mr. Clark's testimony. After his review of the CRA study, Mr. Carsley concluded that the study's estimates for personal income growth in the region and new state income taxes and indirect business taxes may be overstated. Mr. Carsley calculated the present value of new state income taxes and indirect business taxes at the beginning of 2000 would be \$17.4 million and \$47.6 million, respectively, compared to \$27.7 million and \$59.2 million in the CRA study. Mr. Carsley also testified that there are economic benefits from the Chaparral facility that are not included in the CRA study, such as real and personal property taxes assessed on the city and county level and state corporate income taxes. Because the CRA study did not discuss any grants, subsidies, tax credits or other incentives provided by state and local governments to encourage Chaparral to locate in Virginia, Mr. Carsley could not opine whether the Chaparral steel mill would be a net economic benefit to the Commonwealth. (Ex. MC-4, at 6-10).

Mr. Spinner's testimony covered the special rate contract's mechanisms and whether the contract conformed to the guidelines attached as Appendix A to the Commission's Order in Case No. PUE970695, *Ex Parte, In re: Promulgation of Guidelines for Special Rates, Contracts or Incentives pursuant to Virginia Code § 56-235.2 D.* (20 VAC 5-310-10). In addition, Mr. Spinner provided several options to mitigate the effect of the special rate on Columbia's other rate classes for the Commission's consideration. Mr. Spinner expressed the Staff's concern that providing a special rate to Chaparral would cause other customers to bear increased rates absent a finding that the discount was necessary to induce Chaparral to locate in Virginia. Although the dollar amount of any potential harm is small, the Staff was concerned about precedents set and possible discrimination between various classes of customers. To address these concerns, Mr. Spinner recommended the following alternatives to mitigate the impact of the agreement: (1) the special rate contract could be rejected and Chaparral could continue to be served under the TS-2 rate schedule; (2) the contract could be approved and the difference between the contract's revenues and the TS-2 rate schedule's revenues could be imputed in Columbia's next ratemaking proceeding; or (3) Columbia could be directed to make service available to Chaparral under its LVTs rate schedule after lowering the minimum requirement in the availability section of the schedule to Chaparral's maximum daily requirement. (Ex. HS-5, at 5-10).

Ms. Henderson's testimony addressed the ratemaking treatment and cost of service studies supporting the special rate proposed by Columbia. Ms. Henderson's testimony raised two points. First, the Staff modified the allocation of depreciation reserve to match the allocation of depreciation expense in the Application. This allocation altered the returns in the base study for

Columbia's rate classes by reducing the returns for the LVTS class by 2% and for all other classes by less than 1%. The Staff's evaluation of the results indicates that the proposed rates still recover Chaparral's operation and maintenance costs and provide a positive return to Columbia. Second, for ratemaking and cost of service studies, rather than include Chaparral in the LVTS class, the Staff recommended service to Chaparral should be included with the TS-2 class until such time as Chaparral meets the eligibility requirements for LVTS. (Ex. RH-6, at 3-5).

On rebuttal, Mr. Horner reiterated that the special gas rate was instrumental in influencing Chaparral's decision to locate in Virginia. Columbia and Chaparral discussed the prospects of locating the steel mill in Virginia for two years before agreeing to the special rate and contract that is the subject of this proceeding. During the negotiations, Chaparral representatives repeatedly emphasized the highly competitive nature of the steel business and the fact that energy costs could easily determine the success or failure of the mill. Chaparral consistently represented to Columbia that it could not afford to locate its mill in Virginia unless it received natural gas transportation rates that were below existing tariff rates. Mr. Horner also responded to the three alternatives proposed by Mr. Spinner. The first alternative, requiring Chaparral to be served under the TS-2 rate schedule, would not work because Chaparral had already stated it would not have located its facility in Virginia absent the availability of gas service at less than tariff rates. The second alternative, imputing the revenue difference between the special rate and the TS-2 rate schedule to Columbia, would trigger a renegotiation of the service agreement pursuant to Article X-Regulatory Disallowance, which would result in service to Chaparral under the TS-2 rate schedule. The third alternative, expanding the availability of the LVTS rate schedule, is also unacceptable because it unnecessarily expands the LVTS rate schedule to customers that would more appropriately be served under the TS-2 rate schedule. Mr. Horner also disagreed with Ms. Henderson's recommendation that Chaparral should be included in the TS-2 class for allocation study purposes. Because of Chaparral's projected monthly gas consumption, Mr. Horner recommended including Chaparral in the LVTS class, or in a separate customer class. (Ex. REH-7, at 2-5).

On rebuttal, Mr. Clark testified that the Staff's testimony of focusing on whether the special gas transportation contract was solely responsible for Chaparral's decision to locate in Virginia misinterprets and misapplies the special rate statute and guidelines. Mr. Clark testified that the special rate gas transportation contract was part of a series of contracts that were necessary for Chaparral to find a location where it could be as competitive as possible in the steel business. He further testified that the special rate statute and guidelines clearly contemplate such a contract as part of a company's overall business plan to control its energy costs. Mr. Clark believes that the agreement before the Commission results in an "everyone wins" situation for Columbia, Chaparral, Columbia's other customers, and the Commonwealth. (Ex. LC-8, at 1-4).

By agreement, the parties recommended to the Commission that Chaparral should be included in a classification called "Special Contracts, LVTS, and Economic Development" for presentation purposes in future cost of service studies. Such classification would consist of Columbia's present LVTS customer class, LVEDTS class, and any special rate customer, such as Chaparral. (Tr. at 25).

DISCUSSION

The question in this case is whether the record in this case supports Commission approval of Columbia's special rate firm gas transportation contract with Chaparral. The controlling statute provides, in part, that:

- A. . . . [n]otwithstanding § 56-234, the Commission may approve, either in the context of or apart from a rate proceeding after notice to all affected parties and hearing, special rates, contracts or incentives to individual customers or classes of customers where it finds such measures are in the public interest. Such special charges shall not be limited by the provisions of § 56-235.4. . . .
- B. . . .
- C. The Commission shall, before approving special rates, contracts, incentives or other alternative regulatory plans under subsections A and B, ensure that such action (i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable . . . service. (Virginia Code § 56-235.2).

The record in this proceeding supports a finding that the Commission should approve the special rate contract. The public interest is protected under the agreement. Although the total economic benefits of the Chaparral steel mill may not be as great as originally estimated, they are nonetheless significant. By the Staff's estimate, the Chaparral steel mill, at present value, will generate \$17.4 million in new state income taxes and \$47.6 million in indirect business taxes. Chaparral has already invested \$500 million in the mill, which is 25% higher than originally estimated. The mill employs 464 full-time employees at wages that average \$44,000.00 per year, including benefits. The Chaparral mill is Dinwiddie County's largest employer. The location of the mill in Dinwiddie County has no doubt had a profound effect on the economy in the county. Additional businesses have chosen to locate in the area to support Chaparral's operations and to utilize the output of Chaparral's mill. The record is abundantly clear that a motivating factor for Chaparral to locate in Dinwiddie County was the ability to control their utility expenses by negotiating special rate contracts with their electric and gas suppliers. The Commission approved Virginia Power's special electric rate contract with Chaparral in Case No. PUE980333. Likewise, the Commission should approve Columbia's special rate firm gas transportation contract with Chaparral.

No other customer or class of customers will be prejudiced or disadvantaged by approving the contract. The record reflects that the special rate contract will provide a positive return to Columbia and the return on rate base will be positive for all rate classes except the company's LVTS class. The resulting LVTS return on rate base is still above the company's overall cost of capital of 8.96%. The record further reflects that no existing Columbia negotiated-rate customer is precluded at contract renewal from negotiating rates that are at least as favorable as Chaparral's rate. The Staff argues that in the company's next rate case, Columbia's other customers may experience a slightly higher rate increase because of the revenue that was lost because Chaparral did not accept service under the company's TS-2 rate schedule. This argument is somewhat tenuous. One may also argue that the magnitude of any future rate increase for Columbia's other customers was reduced by the addition of Chaparral to the system. The record is un rebutted that a primary motivating factor for Chaparral to locate in Virginia was the flexibility provided by Va. Code § 56-235.2 to negotiate special rates for utility service. If Chaparral had chosen to locate in another state,

the magnitude of any future rate increase for Columbia's other customers would have been greater without Chaparral's contribution to Columbia's fixed costs.

The special rate contract will not jeopardize reliable service to any other Columbia customer. The company's service to Chaparral required the construction of a pipeline system that is not connected to any other part of Columbia's system. The system has sufficient capacity to serve Chaparral and other businesses that choose to locate near the Chaparral facility.

FINDINGS AND RECOMMENDATIONS

Considering the foregoing, I find that the special rate firm gas transportation contract between Columbia and Chaparral meets the requirements of Va. Code § 56-235.2. Accordingly, ***I RECOMMEND*** that the Commission enter an order that: (1) adopts the findings contained in this Report; (2) approves Columbia's special rate and contract for firm transportation of natural gas and balancing services for Chaparral's steel mill in Dinwiddie County; (3) pursuant to the parties' agreement, directs Columbia to include Chaparral in a classification called "Special Contracts, LVTS, and Economic Development" for presentation purposes in future cost of service studies; and (4) dismisses this case from the Commission's docket of active cases.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within fifteen (15) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Michael D. Thomas
Hearing Examiner